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Event Transcript

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Start of Transcript

Graham Chipchase: Good morning everyone and thank you for joining us today for our 2019 half year results announcement. I would like to start with a few key messages about the results. We delivered strong sales revenue growth of 7%, in line with our objective for mid-single digit growth. This performance reflected strong volume growth and improved price realisation in both developed and emerging markets. Our underlying profit was up 1% which is in line with the guidance we provided as part of our first quarter trading update. Underpinning this performance was the strong growth in sales revenue, driven by strong volume and price realisation, which offset a combination of global input cost inflationary pressures and continued cost challenges in the CHEP America segment.

At our 2018 investor day, we outlined a number of initiatives to restore margins in our US pallets business. These initiatives included the accelerated automated program, the lumber procurement program and a number of pricing initiatives. I am pleased to report that these initiatives remain on track to deliver progressive margin benefits over the medium term. Our return on capital invested of 18% remains strong and is well above our cost of capital. As signalled at the full year result announcement, free cash flow after dividends was below the prior period, reflecting a US$30 million reversal of FY18 working capital timing benefits and a US$31 million investment in supply chain efficiency programs, such as the US accelerated automation program. In line with our progressive dividend policy, we have maintained our interim dividend at AUD$0.145. Franking for this dividend has risen to 65% reflecting the timing of Australian tax payments. Going forward, it is expected that franking will revert to 30%, consistent with prior periods.

Turning to slide 4. In the first half of this financial year, we continued to build upon the progress we have made towards achieving our key strategic objectives. In our US pallets business, we successfully implemented new pricing initiatives to align our pricing and contractual terms with the cost-to-serve, whilst also partially offsetting inflationary cost pressures. Importantly, this did no affect our ability to grow as we also achieved 5% sales revenue growth, which is at the higher end of the historical range for our US business. Similarly, we are making good progress in our US accelerated automation program, where we are spending $150 million to $160 million, through to the end of fiscal 21, to automate over 50 plants in the US. This program remains on schedule and we have already completed 10 plant installations and have assessed and approved installations at another 17 sites. This project is a great example of how we are utilising the Group's global best practice and expertise to benefit an individual business.

Now, turning our focus to our Europe, Middle East and African Business. It is again pleasing to report that the strong momentum in sales revenue growth continued into the first half of the 2019 financial year. Looking forward, we're seeing a slow down in the underlying economics of Western Europe and remain weary of the impact that Brexit may have on UK growth. I'll discuss our preparations for Brexit in more detail on the following slide. In our Asia Pacific businesses, we continue to deliver consistent sales revenue growth, and we are expecting this to continue into the second half of the year. Now, turning our attention to Brexit. While still a very fluid situation, I wanted to update you on our preparations. In 2018, we created a Brexit Taskforce, responsible for preparing the business for a number of potential scenarios, including a no-deal Brexit. With approximately 10% of European volumes relating to cross-border flows between Europe and the UK, the taskforce has identified a number of key potential risks for our business and our customer's operations.

These risks include access to pallet and timber supply, changes in customer demand patterns, labour shortages and increased or altered trade and custom regulations. For all of these risks, we have put in place mitigating strategies,

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including the preparation of plants for potential heat treatment capabilities and reducing pallet relocations to Europe. We are already experiencing some disruption, as customers prepare for Brexit by building inventory. In response to the resulting increases in customer inventory levels and extended cycle times, we have spent $11 million of CapEx on additional pallets during the first half of fiscal 19. It is, of course, important to understand that these risks are not unique to Brambles. We do, however, believe that due to our superior scale and depth of expertise, we are uniquely positioned to support customers through any period of transition.

I would now like to provide you with an update on the separation of IFCO from Brambles. In our efforts to ensure that the optimal shareholder outcome is achieved, we are continuing along a dual-track demerger and sale process. This process, whilst on schedule, is not sufficiently advanced to determine the method of separation. As previously announced, as part of the separation we are also undertaking an evaluation of Brambles' capital structure to ensure it is optimal for supporting future growth and shareholder returns, whilst still maintaining a strong balance sheet and credit profile. Finally, from a Group wide perspective, as we look beyond the IFCO separation, we are increasingly looking for opportunities to optimise, modernise and simplify the way we do business and interact with our customers. We will give you more details about this, and the outcome of our capital structure evaluation, in August as part of our full year results announcement.

I'll now hand over to Nessa, who will provide a more detailed overview of the financial results.

Nessa O'Sullivan: Thank you Graham and good morning everyone. I'll start by reviewing our P&L in more detail. Sales revenue growth of 7% represented strong top line growth across all of our regions. Underlying profit increased 1%, reflecting the strong sales contribution to profit and inflation related pricing actions. These were offset by inflationary cost pressures and ongoing cost challenges in CHEP Americas. Significant item expense of US$5.5 million is made up of the costs associated with the IFCO dual-track separation process. Net finance costs decreased, despite the loss of $7.5 million of interest income from the HFG shareholder loan that was repaid in the second half of the 2019 financial year. The lower interest expense in the half reflects the lower coupon rate on the [$500 million EMTN] issued in the first half of 18, which refinanced an EMTN with a higher coupon rate, which matured in the second half of 2018. The reduction in interest costs also reflects the lower net debt balance, following the receipt of proceeds in the second half of last year from the exit of the HFG joint venture and from the sale of the Recycled business.

Tax expense increased due to the cycling of the US$103.2 million non-cash tax benefit associated with the US tax reform, that was recognised in the first half of the 2018 financial year. The effective of tax rate has increased to 29% in the first half as a result of the US tax reform relating to foreign payments, which is effective from 1 July 2018. The decline in profit after tax is largely driven by the cycling of the US$103.2 million tax benefit, booked in the first half of last year, as discussed earlier. The underlying EPS decline is driven by the increase in the effective tax rate. Looking now at sales growth in more detail on slide 9. We delivered revenue growth across all of our business operating segments, driven by strong volume growth in the CHEP pallets businesses and IFCO RPCs in Europe, along with improved price realisation. Turning to the individual components of growth, outlined in the chart on the left-hand side. CHEP realised price mix benefits, driving 2 points of growth, primarily reflecting price increases in the US in response to increased cost-to-serve.

Price realisation also improved across the remaining Americas region and EMEA pallets businesses. The growth in CHEP revenue also includes volume growth of 5%, driven by expansion with new and existing customers, in both developed and emerging markets. IFCO also made a solid contribution to revenue, with strong volume growth in Europe, Latin American and Asia. The growth was partly offset by a mix change in revenue in Europe, with a higher mix of lower revenue, lower cost-to-serve volumes, included in new contract wins. Price growth in North America was offset by lower volumes, as we exited a number of unprofitable contracts and experienced some crate availability constraints during peak periods. Turning to the Group underlying profit bridge. The strong sales contribution to profit of US$89 million was offset by a number of cost increases during the period. Depreciation increased US$14 million, largely due to ongoing investment across all segments, supporting strong revenue growth.

Despite the delivery of supply chain efficiencies across the Group, both plant and transport costs increased during the first half. Net plant costs increased US$21 million, reflecting both lumber and wage inflation in most major markets, as well as additional pallet handling and repair costs, and quality investment in CHEP Americas, which offset operational efficiencies. CHEP Americas higher plant costs also reflected increased costs associated with the ongoing transition from stringer-to-block pallets in Canada, which we would expect to be largely completed during this financial year. The US$32 million increase in net transport costs reflected high inflation in third-party transport, particularly in North America and Europe. The impact in the US market reflects both the longer-haul distances, as well as additional transport miles due to changes in customer behaviour and transport moves associated with capacity constraints across the service centre network.

Other costs increased US$17 million, largely driven by higher cost-to-serve, which includes increased Latin America costs, as highlighted at the full year results. In addition, we've also increased our investment in resources to support the delivery of growth, innovation, network efficiencies and commercial outcomes across the Group. Slide 11 outlines our lumber and transport inflation experienced during the first half. As you can see from the chart on the left-hand side, we have progressively increased the level of lumber and transport inflation recovered through indexation and surcharge mechanisms, in the US and Europe, from 50% in the first half of 2018 financial year, to 75% in this half. It's important to note that price coverage of inflation is more complete in Europe, where most contracts have annual lumber and transport price indexation. In the US, where the average length of contracts is three years, many contracts did not have cost recovery mechanisms in place 12 months ago, when inflation accelerated in the US. To address this, we are progressively putting surcharges into contracts as they are renewed.

In addition, it should be noted that transport inflation is primarily an operating cost driver, while lumber inflation mostly impacts capital costs. As noted at the bottom of the slide, lumber inflation resulted in a US$11 million in CapEx pallet costs in the half. Looking forward, transport inflation is expected to continue to increase in the US and Europe, albeit at a more moderate rate compared to our experience over the last three halves. In terms of lumber, we expect modest decreases in US inflation, however European lumber prices are expected to continue to increase. Now looking at each segment in more detail, starting with CHEP Americas on slide 12. Sales revenue growth of 6% was driven by strong price realisation and volume growth in US pallets, as well as ongoing expansion and price growth in Latin America. In the US, the effect of price - which includes contributions from fuel and transport surcharges - that are recognised as an offset to direct costs, increased 5% in the first half.

Volume growth of 2% reflected ongoing expansion with new and existing customers across the grocery, beverage and SME sectors. Over the next few slides, I will outline the key drivers of the CHEP Americans margin and ROCI decline, as well as the actions we're taking to progressively deliver margin improvements over the medium term. Slide 13 outlines the components and key drivers of the 2.6 percentage point margin decline in CHEP Americas, as well as the actions we're taking to improve margins over the medium term. I will start with CHEP USA, which accounted for 1.7 points of the 2.6 point margin decline in the region. In addition to the elevated levels of input cost inflation, which impact all three business in the CHEP Americas, the US business continues to face a number of structural and cyclical cost pressures, which we've previously outlined. These include capacity constraints in our US service centre network and changes in retailer behaviour, which have driven cost increases, particularly in transport.

In addition to this, and as highlighted at the full year result, we increased our investment in pallet repairs to ensure our customers receive high quality platforms. CHEP Canada continued 0.5 points to the region's margin declined, largely due to additional transport and handling costs, as well as higher service centre costs, as we transition from stringer-to-block pallets. Finally, 0.4 points of the margin decline related to Latin America, where we have seen an increased cost-to-serve, driven by a combination of high growth and the underdeveloped nature of the local network and supply chain, which results in longer cycle time and increases the likelihood of loss and consequently, drives the need for a higher IPEP provisioning and capital expenditure to support growth. In response to these elevated cost levels in this segment,

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we are implementing a number of initiatives to offset cost pressures and improve operation performance and network efficiency. We are also taking pricing actions to better reflect the cost-to-serve in each business.

I have already outlined the progress we've made with pricing initiatives in the US over the last 18 months and noted that given a three-year average contract term, we expect to continue renegotiating terms on contracts which are due for renewal over the next two financial years. In addition to pricing, we're also looking at our own operations for cost saving opportunities. We're investing in supply chain and other cost-out initiatives, such as the US service centre automation program, which will improve both operational efficiency and platform quality. We're also investing resources to improve the efficiency of our networks and to deliver improved commercial outcomes and leverage our global scale and expertise around key spend pools such as lumber.

Now turning to slide 14 for an update on US pallets margin improvement initiatives. As outlined at our 2018 investor day, we set an objective to improve US pallet margins by 2 points to 3 points, from the first half 2018 levels. It's pleasing to note that despite ongoing inflationary pressures, the initiatives we are implementing in the US business remain on track to deliver margin improvement over the medium term. During the half, we continued to optimise our network and transport to drive further efficiencies. In terms of pricing, as detailed earlier in the presentation, effective price realisation during the first half, which includes surcharges, were strong at 5%. As noted by the green circles in the chart, we expect increasing benefits from pricing initiatives over the next three financial years as we renegotiate the remainder of our contracts in our portfolio, which come up for renewal from now, until FY21.

In terms of procurement initiatives, our lumber strategy to reduce pallet unit costs and repair costs remains on track to deliver full benefits by FY21. Importantly, the US automation program, while in the early stages of implementation, is progressing well. Ten site implementations have been completed and the program outcomes are delivering in line with the original business case. Turning to slide 15 ad the CHEP EMEA segment, which continued to deliver strong margins and ROCI, despite cost inflation and ongoing investment for growth. Revenue growth was strong at 9%. The European business maintained good revenue momentum with 5% volume growth, primarily driven by expansion with new customers in the grocery and beverage sectors in central, eastern and southern Europe. Like for like volume growth was modest at 1% and is largely reflective of the macroeconomic conditions in the region. The container businesses delivered particularly strong revenue growth of 24%, driven by a large contract win in the European automotive business and the ongoing expansion of the Kegstar business.

Underlying profit growth of 5% was impressive, particularly given the high levels of transport and lumber inflation experienced in the half and additional costs associated with the growth in the business, which included higher depreciation charges. In addition, the business also increased investment in additional resources to support growth and strategic objectives in the region. ROCI of 26.2% continues to be a highlight and was delivered despite increased investment for growth. This reflects the additional US$29 million of CapEx to support the large contract win in our European automotive business, and US$11 million of Brexit related increased pallet purchases to support higher UK stocking levels.

Our CHEP Asia Pacific business delivered sales growth of 3% and strong underlying profit growth of 5%. The result reflected a solid sales contribution, primarily driven by like for like volume growth and modest pricing gains in Australian pallets. Underlying profit increased 5%, reflecting pricing, the receipt of a one-off government infrastructure grant in the Asia region and the benefit of asset recover outcomes, which more than offset transport and wage inflation. The IFCO businesses continued to expand strongly the first half of 2019. Sales revenue increased 5%, driven by strong volume growth in Europe, Latin American and Asia, and strong pricing growth in North America. In Europe, volume growth was partly offset by a mix change, with contract wins with lower revenue and lower cost-to-serve customers in the UK. These customers are generally lower cost-to-serve as they pay for their own transport outside of the contract. The mix change was a positive contributor to the margin improvement in the period.

Price realisation continued to be strong in North America, offsetting volume declines as a result of the exit of a number of unprofitable contracts during the half and some crate availability constraints during peak demand. Underlying profit increased 9% and margin increased by 0.5 points, driven by a strong sales contribution to profit and transport efficiency gains in Europe. ROCI improved 0.7 percentage points, largely reflecting capital efficiencies and margin improvements in Europe. Turning to slide 18 and our corporate segment. Overall, corporate segment costs decreased US$2 million, with the decrease due to the exit of the HFG joint venture in the second half of last year. The resulting reduced segment cost was partially offset by increased corporate spend and a higher level of BXB Digital cost recognised in the P&L. Corporate costs increased US$3.6 million, reflecting innovation investment and high compliance costs and advisory fees, which included fees associated with US tax reform and other costs.

The year on year BXB Digital spend was largely unchanged, however, the expense increased by US$2.4 million due to the lower level of capitalisation of spend, which reflects increased resources allocated to field trials in the first half of this year, the higher level of capitalised costs in the prior half, largely relating to the development of our software logistics system, BRIX. Looking at our cash flow performance for the year on slide 19. Cash flow from operations declined by US$73.8 million during the period and includes the cash investment of US$31 million in the US supply chain efficiency programs, which are funded by portfolio actions completed in FY18, with approximately $250 million of proceeds banked in the second half of 2018. Excluding the investment in US supply chain efficiency programs, cash flow from operations declined US$42.8 million, largely due to the reversal of a US$30 million working capital timing benefit and lower asset compensations in CHEP Asia Pacific, both of which were disclosed to the market in the FY18 result.

Capital expenditure increased US$46.7 million, reflecting investments to support growth and supply chain efficiencies, as well as additional CapEx to support Brexit related increased stocking levels. I'll cover capital expenditure in more detail on the next slide. Free cash flow after dividends decreased US$63.9 million as the decline in cash flow from operations was partly offset by a lower cash dividend payment, due to a weaker Australian Dollar. Slide 20 provides more detail on our capital expenditure in the first half. Overall, total capital expenditure increased US$73 million, driven by increased investment in growth, including US$29 million investment in the European automotive business, US$31 million in supply chain programs, US$11 million on Brexit related pallet purchases and a further US$11 million increase in investment driven by lumber inflation.

The increased investment required was partly offset by US$35 million of capital efficiencies, primarily in US pallets and IFCO Europe. Of this US$35 million, US$11 million was due to the mix benefit of lower cost crates, with the balance of US$24 million due to efficiency gains across the Group. Looking specifically at pooling CapEx. Pooling CapEx increased US$51 million on 9%, reflecting new platform purchases to support volume growth in existing businesses, as well as US$29 million of new market development capital, primarily to support the contract win in the European automotive business. As mentioned earlier US$22 million of the pooling CapEx increase was driven by a combination of lumber inflation and Brexit related spend.

Our balance sheet remains strong. Net debt to EBITDA decreased from 1.69 times to 1.51 times at 31 December and it is well below our policy of under 1.75 times. The decrease is largely due to reduction in net debt, resulting from the repayment of the HFG shareholder loan and proceeds from the sale of CHEP Recycled in the second half of FY18. Net interest cover increased from 15.2 times to 17.9 times, due to the decrease in net finance costs, despite lower interest income associated with the second half repayment of the HFG shareholder loan. Net debt at 31 December 2018 was US$2.4 billion, an increase of US$99 million reflecting the free cash flow after dividends performance. Before closing I'll provide you with an update on the implications of the new revenue and leasing standards. Starting with the new revenue standard AASB 15, which was introduced at the beginning of FY19, issue fees are now recognised over the estimated cycle time between the asset being issued and returned to Brambles.

As noted in the table on the slide, we recognise a year on year net benefit of US$10 million in the first half of 19, due to the seasonally high fourth quarter sales in FY17 and 18 being deferred into the first half of FY18 and 19. This benefit is expected to reverse in the second half, leaving a net neutral impact for the full FY19 year. All adjustments are non-

cash. Turning to the new lease recognition standard, AASB 16. We are making good progress to developing systems, capabilities and processes to implement the new standard on 1 July 2019. Due to the capitalisation of leases, we currently estimate a 1-point reduction in ROCI in FY20, but we'll be providing a full update at our FY19 results announcement in August.

In summary, we have delivered strong sales performances across all of our segments, driven by volume growth and improved price realisation. In terms of the IFCO separation process, we are on schedule to complete this in calendar year 2019 and we'll provide an update on Brambles capital structure at our full year FY19 results announcement. As noted earlier, we are declaring an interim dividend of AUD$0.145 with a one-off increase in franking to 65%. In terms of future outlook, our global automation, productivity and supply chain cost-out programs remain on track to deliver margin benefits and improve business outcomes over the medium term. We are expecting cash generation to improve in the second half, notwithstanding ongoing investment in supply chain programs. On a full year basis for FY19, we expect constant-currency underlying profit growth to show modest improvement over the prior year, with increased costs to be offset by price realisation and the delivery of efficiency gains. Thank you.

Operator: Ladies and gentlemen, we will now begin the question and answer session. If you wish to ask a question today, please press star one on your telephone and wait for you name to be announced. If you wish to cancel your request at any time, please press the pound or hash key. Your first question today comes from the line of Anthony Moulder from CLSA. Please go ahead.

Anthony Moulder: (CLSA, Analyst) Good morning all. Maybe if I can just start in the US market. Can you - you would see, obviously, very strong pricing benefits in the half, but lower volumes, organic and net new wins. Can you talk to how you see pricing impacting volumes?

Graham Chipchase: No, I think when you say lower volumes, I think the organic growth is actually very much what we think the run rate should be. So, I think, as I said at the full year, when we'd been tracking 2% like for like, that was unusually high. So, 1% I think is fine. The net new business wins, again, we give a range of 1% to 3% as our sort of expectation. So, yes, sure it's at the bottom end of the range but it's still in the range. We haven't seen a significant impact on volumes due to our pricing actions. I think that's partly recognition that it is driven by costs increasing and therefore customers understand it and I think it's also partly due to the fact that the market is being very disciplined and showing the right sort of discipline around volume versus price. Yes, I don't think there's anything to worry about there. I don't think there's anything that we're seeing unusual. I think you just always have to keep an eye out for your macro statements from the US administration as to what might happen with like for like volumes. But at 1%, we're sort of hanging out in our normal range.

Anthony Moulder: (CLSA, Analyst) Right, okay so - that kind of level you'd expect to continue, around that sort of one on one?

Graham Chipchase: Like I said, at - notwithstanding a statement from the Whitehouse which might impact the GDP of the US, yes, that's what we would normally expect.

Anthony Moulder: (CLSA, Analyst) Okay. You mentioned cost-to-serve pricing initiatives in the US. Can you talk to more detail as to how and where you're putting those through?

Nessa O'Sullivan: Yes, sure Anthony, it's Nessa here. Look, what we've been doing as contracts have come up for renewal is that we're putting a lot more rigour to understand the cost-to-serve, i.e. the exact costs that that particular - those particular flows attract. As a result of that, we are changing pricing. So, we're doing a lot more tailored pricing actions and we're also - at the same time, when we're looking at how costs arrive from customers, working with customers to see how we can actually take out costs at the same time. But it's fair to say we're having a more detailed and thorough review of the actual costs associated with each individual customer as we're establishing the right pricing.

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Anthony Moulder: (CLSA, Analyst) So, I take from that that it's more customer by customer, not channel by channel? Or is it channel by channel? Is it also NPD related? Obviously…

Nessa O'Sullivan: Anthony, it's both because as we look at customer flows, we look at where their products end up because there's a variety. Some of them will end up in participating distributors. Others will end up in non-participating. So, it's a bit of a combination of the both - of both things, recognising that depending on which channel they end up with, that they have different costs associated with service, both in terms of getting the pallets there but also the returns, the loss rates and the damage rates associated with that.

Anthony Moulder: (CLSA, Analyst) Last question on the US. Obviously, 10 of sites now converted to an automated repair process. When do you expect to see some, I guess, lowering of that capacity impact that you've had over the last year and a half now?

Graham Chipchase: Well, I think we - yes, what we're anticipating, it's partly why we're saying what we're saying about the full year outlook is where we would expect to see some of it coming into play second half of this year. Obviously, if you look at Nessa's - the slide she was talking about with the green dots on, you see it progressively coming through in 20, 21 and 22. But we are beginning to see improvements on the 10 sites we've already implemented.

Anthony Moulder: (CLSA, Analyst) Because arguably, they're probably the worst for the capacity impacts? Wouldn't they be?

Graham Chipchase: Yes, so - well, I mean, there's a - is a combination of the ones which were the least efficient, and therefore obviously give you a bigger bang for your buck. But not just that, because some of them we've converted where we had the tightest capacity constraints. So, yes, I mean, for sure. We should be seeing a good improvement through this year as we convert more and more sites. But the full benefit won't be for a few more years as we mentioned right - back in the investor day.

Anthony Moulder: (CLSA, Analyst) Sure, understood. IFCO, obviously, we're probably hoping for an update on indicative bids, I think, by the end of March - I think was the previous guidance. Has that changed? You still confident in just giving - or is that the timing for indicative bids for IFCO?

Graham Chipchase: We didn't give a timetable on indicative bids. I think all we said was that we would complete the separation by the end of calendar year 19, which I know is not terribly helpful, but that's what we said. So, where we are now and you may have noticed we put out a release to the ASX this morning, just because there's been quite a lot of media speculation. All we're saying is that the separation process is on track. We do expect to complete within 2019. But we are still going through both processes. So, whilst the assessment of the sale interest is an advanced stage, both processes are incomplete. We continue workstreams on both and as soon as we have any developments, we will inform the market. So, at the moment, it's a situation as it was before.

Anthony Moulder: (CLSA, Analyst) Yes, thank you. Last question around Brexit. Obviously, you've quantified an impact from that - longer cycle times for the pallets business, appreciate that IFCO doesn't have that kind of constraint but - or impact, but are you expecting any impact from Brexit, depending on how that plays out, through the IFCO business?

Graham Chipchase: There might be a little bit in terms of retailers stockpiling but we haven't seen it and we - but whereas we have seen it on the pallets side. So, I wouldn't expect there to be any material impact on IFCO.

Anthony Moulder: (CLSA, Analyst) Perfect. Thank you very much.

Graham Chipchase: Bye.

Operator: Your next question comes from the line of Matt Ryan from UBS. Please go ahead.

Matt Ryan: (UBS, Analyst) Hi Graham, hi Nessa. First question on US margins. As you've sort of highlighted, cost inflation appears to be moderating at the moment. Appreciate that you've got contracts in place so the benefits that you guys might get might be a little bit more delayed than the spot markets that we can see. But I guess with what you can see at the moment, how confident are you that 2019 will be the low point of margins?

Nessa O'Sullivan: Look, for us it really depends on what happens with inflation. For - as we went through the first half, we saw effectively really transport has been the biggest single impact and it's weighted towards the US where we have longer haulage miles and also, we have the added issue of increased re-handling because of the inefficiencies in the network. So, look as we get into second half, we obviously - the comps - we're obviously cycling a higher inflationary period so the period on period in the second half shouldn't be as severe. That's the key component. Then the chart that we set out on chart 14, which shows the margin initiatives that come into play. They are progressively delivering but really the biggest impact is really FY21 and 22. We're confident that those building blocks are in place but we are little bit held to ransom with what happens with inflation.

Matt Ryan: (UBS, Analyst) Okay, and then the - I guess, the 2% to 3% margin improvement, which I think you've reiterated today, I think, previously there was a year of 2021 when you'd achieve that. Has that changed?

Nessa O'Sullivan: We're showing that we get to FY22 when all of the benefits come through within that range. But we would expect, as we get to FY21, to be able to show material progress against that.

Matt Ryan: (UBS, Analyst) Would that year be within the 2% to 3% improvement that you've been speaking about?

Nessa O'Sullivan: Remains to be seen in terms of total commitment because we're not giving guidance by year. But you would expect if we needed to get within that range of 2% to 3%, that FY21 should show material progress which should get you pretty close to the bottom end, but without giving any guidance.

Matt Ryan: (UBS, Analyst) Okay. Then I guess just with the outlook commentary today, can you give us any colour on what you mean by modest? I guess, maybe just to frame it in the context of your medium-term guidance for profit above revenue growth, is safe to say maybe that we're not going to see that this year?

Graham Chipchase: I think that's a very fair statement. What we - if we go back to the comment around the operating profit leverage, we did say through the cycle and that - in that - if that meant that if you had periods of high cost inflation you wouldn't be able to get the leverage. I think we can all agree we're in a period of high cost inflation so there'll be no leverage this year. I think when we say modest, I mean, you - we all have different views, but you can see what we did in the first half and we expect it to be slightly better in the second half, therefore, to get to the full year to be slightly better overall. I think that's all we can say. You'll have your own view about what modest means.

Matt Ryan: (UBS, Analyst) Okay. Thank you.

Operator: Your next question comes from the line of Owen Birrell from Goldman Sachs. Please go ahead.

Owen Birrell: (Goldman Sachs, Analyst) Hi guys. We're just going to labour the point on the US just a little bit first. You mentioned on slide 10, changing customer behaviours in the US. I wonder if you could just provide a little bit more colour around what you mean by that?

Graham Chipchase: Yes, I mean, it's the thing that I think we've talked about fairly consistently over the last few reporting periods, around things like in certain instances, us having to pick up pallets whereas in the past the customers

would have taken it back to our service centres for us. The move which started over a year ago now of certain retailers wanting to charge for sorting pallets. That's the sort of thing we're talking about and yes, and it has been growing but I don't think it's something we can't deal with, it's just one of those things where we have to, through a mixture of pricing and being more efficient ourselves, offset it over time. That's - I think that's what we - we're in the progress of - process of doing.

Owen Birrell: (Goldman Sachs, Analyst) So, it's not to do with customers using less pallets or better inventory management, thinks like that? It's just the - I guess, the collection and the supply chain side of it?

Graham Chipchase: Yes.

Owen Birrell: (Goldman Sachs, Analyst) Okay and can I just ask, we're seeing pallet pricing in the US falling quite dramatically. Last time we saw this happen it had a major impact on white wood conversions in the subsequent period. Any expectation of that happening around this time?

Graham Chipchase: Again, it's one of those things. We haven't seen much happening, but - and yes - and you know - I think I've said this before. My view is there isn't a direct correlation between the two, because people go to pooling for reasons other than price. But I mean, when you get periods at the extreme of very very high white wood pricing or very very low white wood pricing, then it can make a bit of difference. So, yes, if white wood prices come down a lot, then I think our view is, well that means that you might only get down to the bottom end of our range on net new business wins rather than the higher end. Sure enough, we are at the bottom end at the moment so there may be some correlation there. But we haven't seen anything noticeable yet.

Owen Birrell: (Goldman Sachs, Analyst) Understood. Capacity constraints, you mentioned increasing costs in the US. Is this as a result of automation? Or has it got more to do with this increased need to collect pallets and your supply chain?

Nessa O'Sullivan: It's really going back to us when we identified that the US capacity was not where it needed to be to operate efficiently. So, as we're investing, it means that in certain cases we're taking capacity out of the market as we automate plants and upgrade plants. We're trying to do that in a way not to cause issues for our customers service levels, but that does mean increased rehandling costs to put them through other plants, to run overtime and rehandling. Until we actually get more through the automation program, where we'd need to see another 12 months going forward, we are still going to have those increasing levels of inefficiency because we're growing at the same time as we're taking out capacity.

Owen Birrell: (Goldman Sachs, Analyst) Understood. Are you able to put a dollar value around that overhead cost that you're having to bear and essentially will come out at the other side?

Nessa O'Sullivan: Look, when we look at the overall US margin decline, we would say, of the efficiencies, we would have - there'd be a point of inefficiency there.

Owen Birrell: (Goldman Sachs, Analyst) Okay. I guess, just finally on the US, the cost-coverage in your US contracts. You mentioned at the Group it's about 75%. I'm just wondering if you can give us an update for the US market specifically?

Nessa O'Sullivan: Yes, look, we feel we have made really good progress in terms of the recovery because it's about also - about what - so, as we get into the US contracts, we started from having very low coverage, but there was some in there. So, we had - we started off about 12 months ago with sort of 50 plus coverage, and we're sort of - we're - been progressively moving that up. We'd be for the high sixties, low seventies. While we have price indexation in Europe - while we have good coverage, it doesn't cover every component of it. Plus, also, you have to realise that with Europe,

the indexation happens generally on 1 July so therefore, it captures what's moved in the year. But as you have increased beyond that you also get impacted. When we look at overall coverage, we're looking at both those components, i.e. a catch-up with the contracts in the US not having it, but also that the indexation largely in Europe happens on 1 July. When we talk about that, we take all the costs together, all the recoveries that we get from it to get to that number. That's where we're going to continue to track to see that we're progressively making improvements in that.

Owen Birrell: (Goldman Sachs, Analyst) Okay, excellent. Just - look, one last one if I may on IFCO. The prices effectively went backwards during the period. I'm just wondering if you can give us a bit more colour around what happened there and if there was a one-off, what did the underlying price movement do? Because I understand previously you were talking about price levers as being a big driver of the sales line there?

Nessa O'Sullivan: Yes, well - look, generally in Europe, the team has done a really nice job of investing in price to get volumes and we continue to see that. But the results in IFCO Europe, where we did have a net net price decline, we're also impacted, that we did take on a number of contracts that were high volume that are lower revenue per issue, but they're also lower cost-to-serve where customers take on their own transport. That's reflected in there as well. We continue to get strong pricing in the US, but really Europe, it was more business as usual and then - but overlaid with this step change in mix, where we had some big customer wins that fundamentally, the shape of the revenue and the cost is different. But it was a positive contributor - that mix change - to margin in the period.

Owen Birrell: (Goldman Sachs, Analyst) Alright, that's great. Okay, thank you guys.

Operator: Your next question comes from the line of Jakob Cakarnis from Citi. Please go ahead.

Jakob Cakarnis: (Citi, Analyst) Morning guys. Two quick ones from me. Firstly, can you just comment on the state of competition in the US market, please, and how that might look if we do see these inflationary head winds recede in the second half of 19?

Graham Chipchase: Yes, so, I mean I think the - as I said earlier, the competition has been very disciplined and it's been good that when we've been announcing the fact that we have been - we're going to increase prices to cover the inflationary cost increases, as far as we can tell, the competition are following as well so that's great. I think if the inflationary cost pressures come down, you would expect there to be the same discipline because there is still capacity constraints and we've been very careful that if we - we're managing our volumes to an extent and if we lose - if we think that there's business we're going to lose, well then we'd hope that that would be business that the competition would find would fit their network better than ours. That's why we'll be prepared to lose it and I think as long as that discipline is still held in the market, through both the increasing inflationary pressures as well as the decreasing, there should be no change to the statement of, the markets behaving in a disciplined way. That's what I would expect to say.

Jakob Cakarnis: (Citi, Analyst) Okay, thanks for that. Now just moving to the CapEx. I know that there's been an increase in the pooling CapEx. I'm just wondering if there's any discussions with customers regarding pallet quality when you're talking about pricing changes or at the recontracting stage, please?

Graham Chipchase: I mean, there's always a conversation about pallet quality but I think one of the things that we've seen just around the promoter surveys and scores is that, when - I think, particularly in places like the US, there were comments a few years ago, particularly in comparing us with the competition. Those have died down significantly through a combination of the competitors' pool getting older, but also us investing in quality which we have been doing over the last year or two. It's not something that comes up particularly at the moment and I think that's an indicator of the fact that we're investing in the right things and talking to our customers about their needs and the standards that they need, to make sure that what we're providing them is fit for purpose.

Jakob Cakarnis: (Citi, Analyst) Sure. One final one for me. Just - you've spoken to the CapEx implications from Brexit in the UK. Can you talk through any OpEx or revenue impacts that you experienced in the first half of 19 please?

Graham Chipchase: Yes, there haven't been any real OpEx impacts. I mean, there might be going forward. Depends a little bit on the risks we outlined on Brexit and in particular, the heat treatment of pallets. If that has to happen, which we still don't know whether it will or it won't, then not only will there be a bit of a CapEx implication for us, but clearly that will flow through in OpEx. But we would aim, I think, to pass that onto customers because it's an increased cost of being outside of the EU. Apart from that, again, the risks that we've seen - we've highlighted around things like availability of labour and delays with - or tariffs - increased tariffs. It's too soon to know what will happen and therefore we haven't seen any impact through the P&L yet.

Jakob Cakarnis: (Citi, Analyst) Thank you.

Operator: Your next question comes from the line of Cameron McDonald from Evans and Partners. Please go ahead.

Cameron McDonald: (Evans and Partners, Analyst) Good morning. Just a couple of follow-up questions. One on that - on the Brexit CapEx. Presumably that's a one-off? Or are you calling that out as something that Brexit is going to continue to drive up - that CapEx requirement?

Graham Chipchase: Well, it should be a one-off because what we're seeing is it's related to our customers obviously stockpiling and therefore us having to inject more pallets into the system. One would expect that once Brexit - whatever Brexit ends up being - returns to some sort of level of normality. Those extra pallets you put in will kind of - we won't need to put quite so many in in future periods. The only thing we don't know is just how long this period of uncertainty and if there is going to be a bottle-neck at the pool which - whether that's going to continue for any length of time. If it does continue for 12 months, then we might have to put some more CapEx in. But at the moment, we're - we would be calling it out as a one-off.

Cameron McDonald: (Evans and Partners, Analyst) Okay. You've called out an infrastructure grant in Asia Pacific as positively contributing. Can you quantify how much that was please?

Nessa O'Sullivan: Yes, look, a relatively small amount. You should think less that $1 million in terms of your total earnings but it was due to us investing in innovation where we were able to, under some programs in Asia, to actually reclaim some of those costs on - from government grants.

Cameron McDonald: (Evans and Partners, Analyst) Okay. Then two relating to the US. You've called out the efficiency and the capacity constraints in the US. Is that - or are you seeing customers then adjusting their return behaviour, and in effect, hoarding pallets to provide some level of their own insurance against your capacity constraints?

Graham Chipchase: No, not seeing that at all.

Cameron McDonald: (Evans and Partners, Analyst) Okay.

Nessa O'Sullivan: No, and generally - look, our customers wouldn't have the space to be able to stockpile pallets either.

Cameron McDonald: (Evans and Partners, Analyst) Okay. Last question just in terms of the detail and the number of pallets. You had 140 million pallets at the end of FY18 and - in CHEP Americas. You're saying now that you've got 141 million and yet you've purchased 11 million during the period. Can you just explain where the 10 million has disappeared to?

Nessa O'Sullivan: Yes, sure. So, look, if you have a look - if you just look at the pallets line there. We have 139 million pallets in the - at the beginning of the year. We had purchases of 11 million. Then we have an IPEP of 5 million. The provision against that would be 5 million pallets which includes, remember, we highlighted in Americas, to expect as we go through that we will have higher provisioning particularly in Latin America. So, you've got to factor that into your Americas region. We also then would have about - the normal course of business, about 2 million worth of pallets - and a half - would be written off. Then we'd get a further - we have had a further 2 million-odd where we get compensations for, i.e. where people pay for those pallets because they're responsible for the losses associated with them. Essentially, if you have a look at that, that takes you from the 139 million to the closing 141 million. As I said, for 2 million of those we would have compensations across - against that, which you'd see on the cash flow line under the proceeds from sale of property, plant and equipment.

Cameron McDonald: (Evans and Partners, Analyst) Okay, thank you. That's great.

Operator: Your next question comes from the line of Paul Butler from Credit Suisse. Please go ahead.

Paul Butler: (Credit Suisse, Analyst) Hi, good morning. I just had a question on the price increases that you're getting through in the US. You said, I think, effective 5% price increase. So, given that you've got three-year contracts and I presume that relates to just a third of your contracts, the effective increase per contract is something like, 15%? Is that reasonable?

Nessa O'Sullivan: No, how you would look at it is that we get raw pricing on the top line, but the surcharge pricing that we get for those - so, for everybody who has got it in, if the cost of something the surcharge applies to goes up, then that pricing that we get from that goes up as well. It's not just over the smaller amount that you're looking at the increase in surcharge income, it's the income that's increased across the whole of the pool.

Paul Butler: (Credit Suisse, Analyst) So, does that mean it's more like 10% increases for the contracts - the further contracts?

Nessa O'Sullivan: It vary - it really varies - it - very very widely. As we were doing the reviews and we look at the real cost-to-serve, it's a combination where we could take costs out of flows with customers, which would reduce the amount of the increase that they've got - that we have to pass on. Or it can be - in some contracts, some have - some bring a lot of benefits to our network, where their increase would be lower than others that don't bring as much benefit, and they cost us more to serve. So, if you have a much higher mix, say, in the non-participating distributor, or if you have a higher loss rate or longer cycle times overall, then generally, your price increases will be higher than other who have less flows into those NPD and have shorter cycle times, for example.

Operator: Your next question comes from the line of Scott Ryall from Remor Equity - sorry - Rimor Equity Research. Please go ahead.

Scott Ryall: (Rimor Equity Research, Analyst) Great, thank you. Graham, you made some comments about your - about pallet quality in the US having improved and not being really a discussion point. But in the increases in costs, you've called out increased investment in US pallet quality. Is that - am I missing something? Or are you saying, because you're spending, you're not having the conversations with customers anymore?

Graham Chipchase: No, all I was saying was that because we have been investing in quality, which is - it's not a big increase year on year, but it's something that hadn't been going on some years ago, when I think that we were getting more noise about pallet quality in the US. I think that was a combination of us not investing so much in the pool, but also, competitors' pools being much younger. So, all I'm saying is that the noise has definitely reduced because we're - because of both those factors moving, i.e. the competitors' pallet pool is getting older, but also, we are investing more than we have been in the past on quality. But it's not a significant amount but it's more than we were doing before.

Scott Ryall: (Rimor Equity Research, Analyst) Okay. Could you just - in terms of the Canadian shift from stringers to block pallets, how far along in the transition are we, please?

Nessa O'Sullivan: Scott, we'd expect that we would be - reach a balance point by the end of this financial year. So, last year we said expect an additional $9 million in costs, year on year. So, we had about $9 million last year - expected an incremental $9 million. So, from where we're seeing the progress and the costs, it is playing out the way we expected. But we would expect then, as we get into next year - next fiscal year, that we shouldn't be seeing more incremental costs come through in relation to that transition.

Scott Ryall: (Rimor Equity Research, Analyst) Okay, great. Could you talk - in the IFCO business, you mentioned in the US you've exited unprofitable contracts. Clearly, the price makes the unprofitable, but could you just explain to me, when you presumably tried to renegotiate with the customers of those unprofitable contracts, why you weren't able to come to an agreement on price, please?

Graham Chipchase: Well, depends - I mean, there'll be lots of different reasons. There might be alternatives. Some of them may have flipped back to [Corrugate] because they decided that the price increase was too great. It could just be that they decided that the price increase was too great and they didn't like it. It could just - it could be something that was going to happen anyway and it wasn't just about the price. There's a whole range of things. But from our perspective, it was very important that we start taking a bit of a stricter view on those contracts that were not profitable. The good news is that the ones that are left are profitable and are doing quite well and you can sort of see that through the numbers. But it's been one of those things that I think is a culmination of the last few years of price increases and it was definitely going to affect volume at some point.

Scott Ryall: (Rimor Equity Research, Analyst) Okay. So, do you think you're through that period now of taking out those sort of contracts?

Graham Chipchase: I think it's - yes, we're - hard to call, I think, is the answer to that one. I think we probably got through a lot of it in the last six months, nine months. Hopefully it will get better but I don't really want to call that one just yet.

Scott Ryall: (Rimor Equity Research, Analyst) No, that's fine. Okay. Then could you talk about the - some of your technology trials, particularly around tracking and what the progress of that has been, please?

Graham Chipchase: Yep, so I think we've started to get some really good insight, particularly in the US, around what's happening in the NPD channels and I think that sort of links back to some of Nessa's comments around pricing. Which I think, with that data, it allows us to go back to some of the customers and saying, okay more of your product is going through the NPD channel, we now have a better idea of cost-to-serve and therefore that informs our pricing decisions. So, we're definitely getting some of that out of the BXB Digital trials. We're also working on some of the other historically difficult channels in the US, which everyone knows who they are, but we won't talk about them right now. But also, in Europe, we're doing some more work in Spain. I think, again, we're seeing a bit more - getting more insight.

So, what we've said - and I think we said it in August last year, is expect by the end of the fiscal year this year, to come back to you and say, here's what the value has been of the trials. I don't think there's anything to - from our perspective, that says, we won't be able to do that. It's clearly - this is a longer-term play, but we are beginning to see some value now.

Scott Ryall: (Rimor Equity Research, Analyst) Mm-hm sure. What about - I mean, a lot of that is related to your cost base. What about value-add to customers in terms of temperature tracking and other conditions and those sorts of things, please?

Graham Chipchase: Yes, so I mean, we are doing some of that as well and we've got a couple of projects which are progressing well. I just think, in terms of - you'll not see it in the numbers, it's so small in terms of the value, it's not going to change the dial. From our perspective, the value of focusing people's efforts and attention on the asset efficiency, the cost of service is so much greater than anything else we can do. We just got to be a bit careful about not spreading ourselves too thinly but we're trying to keep the customer value piece alive, but it's not the top priority at the moment.

Scott Ryall: (Rimor Equity Research, Analyst) Mm-hm, okay. Thank you, that's all I had.

Operator: Your next question comes from the line of Michael Morrison from Deutsche Bank. Please go ahead.

Michael Morrison: (Deutsche Bank, Analyst) Hi, just a query on - you talked previously about the rationale for the IFCO sale or demerger, and you talked about synergies, customers being different decision makers and then funding. You've talked about short-term CapEx for the automation coming from some of the asset sales, like Recycled. Then back at the last year's investor day, you did talk about - could take up to 10 years to develop a new pallet market. Could you give us some colour around either capital management or how you might deploy the proceeds from an IFCO sale?

Graham Chipchase: Well, I mean, I think it's premature to talk about proceeds from an IFCO sale because we may demerge it. So, I don't think I'm going to give too much colour on that. But I think if you just think the - theoretically, what we've said is that if we haven't got any material projects which are value accretive and where we - which we can't fund from ongoing cashflows, then yep, we clearly would use some proceeds for those sorts of projects because why wouldn't we? Because they're value accretive. But if there aren't any in the short-term - and I think we're talking 12 months, 18 months, then we would return the proceeds, if there are any proceeds, to shareholders. How we do that, clearly, we'll have to address at the time. So, I think that's probably as much as I can say on it at the moment.

Nessa O'Sullivan: And debt, obviously, we'd do as well.

Graham Chipchase: Yes.

Michael Morrison: (Deutsche Bank, Analyst) Okay. You've talked about speaking to customers about the value-add as well as catching up on the cost inflation. Could you give us a bit more colour around that? You talk about the quality of the pallets but some more colour around just - when you sit down with the customers, what are the other things you talk about?

Graham Chipchase: Well, I mean, the clear thing that we do talk about, apart from the quality, is the value of our network advantage because if you're a customer purely looking for the lowest price, you can undoubtedly cherry pick lanes. But then, the whole benefit of having a pooled system is you actually use the network advantage and they'll be the lanes which we also serve which are less - are higher cost-to-serve. That - if you take - if you start bifurcating those two types of channels, you actually increase net cost for the customer so that's one thing we'll always talk about. Places like Europe in particular, we do a lot of conversation around transport collaboration. We're a - many customers now where we're saving them significant amounts of money on transport to the extent that that becomes a big factor in whether they even retender the business, because actually, we can prove to them how much we're saving. I think that's a clear indicator around value. Then you start having some conversations, as I said to the earlier question around what we can do with our insights using the data, but I think that's still at a fairly early stage.

Michael Morrison: (Deutsche Bank, Analyst) Okay. Then a last question, just as you suggested, the news wires are busy talking about potential sales and they mention one particular PE firm. But when it comes down to making a decision about a demerger or a sale, is it really all about the price? Or is there other things you're considering?

Graham Chipchase: Well, it's about the value, for sure, and it's about the value to shareholders. I sort of use that word quite carefully because clearly, you would look at tax implications for shareholders as well as just the price as well. Then you start thinking about work from a cultural perspective if you were looking at buyers. Also, you'd have to start looking at the capabilities and making sure that we've got the right capabilities in the team should it be demerged and be a standalone entity. So, it's not just about the price.

Michael Morrison: (Deutsche Bank, Analyst) Okay. Thank you.

Operator: Your next question comes from the line of Paul Butler from Credit Suisse. Please go ahead.

Paul Butler: (Credit Suisse, Analyst) Hi, I seem to have got cut up before.

Graham Chipchase: We thought you were just being rude.

Paul Butler: (Credit Suisse, Analyst) Well, I didn't think my question was that contentious. So, look just back onto that - so, there's the 3% increase you've reported, 5% effective. Is there any specific reasons why, over the next two years where you're continuing - where you're expecting continued price increases, it would be a different sort of magnitude to what you've talked about today?

Nessa O'Sullivan: Well, the increases will be dependent on - that come from surcharges will be dependent on where inflation is. But we would expect as we got forward to FY21, regardless of where inflation is, that we will have contracts that are much better positioned for us to face these kind of head winds again. The challenge for us now is that we're in catch-up mode and it will take us through a three-year cycle to get to all of the contracts. That's not an ideal position to be in, but I think we've made good progress with 75% recovery. I'd say we'd kind of - you - we won't have it in every single contract - the surcharges. Some of them will be just - will be through pricing. We might get overall to sort of 80% plus but I think this leaves us just - the key objective being that we continue to make progress to recover the costs and that we have contracts in the future that are best place to manage changes - better placed to manage changes in the market.

Paul Butler: (Credit Suisse, Analyst) Okay. In Canada, there's a previous question and I think you said that there won't be any additional cost or margin impact in FY20. I'm just wondering, at what point does these additional costs reverse out and we actually get a margin benefit related to Canada?

Nessa O'Sullivan: Yes, well, we have - look, on an ongoing basis, the challenge is that block pallets are not as robust as stringer pallets. The challenge with that is that when you shift a pool over from stringer, we've enjoyed a market where we've had much lower damage rates and much lower repair costs because we were running a stringer pool. It's going to be - there is - the majority of the costs that we've now got will continue on because we will have a pool that reflects a higher damage rate. There is a portion of that cost - a smaller portion of it that relates to just losses as you transition over. However, there will be - you shouldn't be expecting there's going to be a big margin uptake. This is more, we had good margins, the margins come down, there's still going to be - it's still going to be a good returning market, albeit at lower margins than it was sitting on a stringer pool.

Paul Butler: (Credit Suisse, Analyst) Right, so I mean the customers and the supply chain in general gets a logistics efficiency benefit from the block pallets versus the stringers. Do you get a pricing benefit to share in that?

Nessa O'Sullivan: The challenge for us is, first of all, customers. The reason why we're shifting the pool is because customers prefer the pallets with the four-way entry which makes it more efficient for them in terms of warehouse management and their own logistics. So, yes, there is a reason why customers want it. In terms of the pricing, there are other competitors in the market, who also price in the market, which determines the prices of those block pallets in

market. We don't have the opportunity to increase the issue prices proportionately with the higher costs for the damage rates et cetera associated with that pool.

Paul Butler: (Credit Suisse, Analyst) Okay. I just had a question on the AASB 15 adjustment.

Nessa O'Sullivan: Yes.

Paul Butler: (Credit Suisse, Analyst) I think for the prior year there was about a $15 million adjustment related to the Americas business which was proportionately larger than for the other businesses. I'm just wondering why that is?

Nessa O'Sullivan: Look, the adjustment is purely due to the shape of the revenue earnt in each of the markets. So, where you have a business that has higher quarter four sales relative to in the first half, then you're going to have a higher deferral at the end of the year because you'll have more income that has to be spread over the cycle time. So, if you're issuing more sales in the fourth quarter, then it comes to year end cut-off, you're going to have a bigger quantum of deferral because if you take it that you turn a pallet three times a year, there's still going to be income from that fourth quarter that gets spread across the next half. It's to do with the shape of the earnings and traditionally, from a Group perspective as well, we do have a higher quarter four, relative to the second quarter. Hence why you will have the shape of this.

In the first half, if you look at it year on year, because we restated the prior year numbers under the old standard and now, we're running under the new standard. Net net the impact on first half is that was have a US$10 million increase in underlying profit in the first half and we would expect that to fully reverse in the second half, purely due to the shape of the sales revenue.

Paul Butler: (Credit Suisse, Analyst) Okay. Graham a question for you. Given your visibility over the supply chain, I'm just wondering if you can comment on how well you think the supply chain is preparing for the various Brexit scenarios that we might see?

Graham Chipchase: I think the answer is that people are preparing for it pretty well and I think there's - I'll give you a couple of examples, I suppose. I know through some of my other sort of - living in the UK, you hear a bit more about this. A lot of the retailers, for example, were being contacted by the government about what their plans were for stocking and this is back in January. They said, well we've already made our plans and it's too late to tell us to do something different. So, they had already assumed a no-deal Brexit as far back as Christmas and that - and had planned accordingly. I think people have actually gone ahead and taken a pretty gloomy scenario around no-deal Brexit and have planned appropriately. Other companies, obviously I know a bit better, have done exactly that as well. I would say people have planned appropriately.

I - and then I'll say this, it's slightly controversial. I do think that we're focusing a lot on Brexit but actually, we ought to be looking at what's going on in the rest of Europe and it's not just about Brexit. If you look at the economies in Germany and France and Italy in particular, those are all under some pressure so I think we should be thinking more about just what's happening with GDP in Europe generally, rather than just focusing on Brexit. But I know that's a hot topic for people at the moment.

Paul Butler: (Credit Suisse, Analyst) Thanks very much.

Graham Chipchase: Thanks.

Operator: Your next question comes from the line of Owen Birrell from Goldman Sachs. Please go ahead.

Owen Birrell: (Goldman Sachs, Analyst) Hi. I - just a couple of follow-up question from me. Just firstly on US margins. You're talking to previous guidance of 2% to 3% increase on first half 18, sort of implying at the mid-point around about a 18.7% margin in the US. That's effectively a 30% increase on your profitability out of the US or circa $50 million of cost savings or cost recovery. That's a pretty big number. How confident are you that you can actually achieve that?

Nessa O'Sullivan: Look, we - if you look to slide 14, when you look at the automation project, just take that as one chunk of it. We talk about the - we were going to spend $160 million and we expect to get returns of 20% on that. That starts to get you into a big chunk of where it comes from. Then we have lumber saving and pricing on top of that. Look, obviously as we look at the margins, they'll get restated with changes in accounting policy et cetera. But we're holding ourselves to account in terms of we said we had initiatives in that would deliver incremental benefits that we expected to flow through to the bottom line and we believe we're on track, albeit that the benefits are skewed towards 21, 22.

Owen Birrell: (Goldman Sachs, Analyst) Okay. Just a second question from me on, you've mentioned this capital structure review post an IFCO transaction. It seems to be that IFCO needs a fair degree of capital and Brambles is obviously continuing to invest. I'm just wondering, as part of that capital structure review, if we get a demerger scenario, whether there's a possibility of the capital raising at that point as well?

Graham Chipchase: That's not our intention.

Nessa O'Sullivan: No.

Owen Birrell: (Goldman Sachs, Analyst) Okay, excellent. That's great, thanks.

Operator: Just a reminder ladies and gentlemen, if you do wish you to ask a question today, please press star one. Thank you.

Nessa O'Sullivan: We can answer the question - there's one here on the screen that we can answer. I think we've probably covered it but Piers Bolger asked, do we think we're at the peak of the cycle as it relates to inflationary pressures from lumber and transport? Then part b of that question, do we envisage that we'll pass through more than 75% of that? I think I'd reference you to the slide 11. We're saying, look, inflation has been higher than we would have expected coming into the year. Our outlook is that we expect transport to continue to go up, albeit we see the [CAS] index and some of the other outlooks are indicating they would expect to see a moderation in that. We've yet to see that come through to the extent that some of those indices would say. Lumber, we are still seeing some increases. Certainly, in the half we saw increases year on year, but we do think we have seen steep inflation. We wouldn't expect it to continue at the same rate.

In terms of us moving through recovery, maybe we'll get to a target, sort of 80% to 85% might be where you sort of end up across all your contracts. A bit of that remains to be seen because it will depend on what we get on top line pricing and where we see the cost-to-serve. Some of it may just involve changing other clauses, for instance, where we don't take so many transport legs ourselves. There's a number of other ways that we can address that too. There was also a third question on European growth and I think Graham's just covered that, saying that we are seeing some weakness in the macroeconomic outlook as well, across Europe.

Operator: There are no further phone questions at this time. I would like to hand the conference back to today's presenters. Please continue.

Graham Chipchase: Great, we'll just say thank you very much for your time and for the questions and I'm sure we'll be seeing many of you in the next day or two. Thanks very much.

Nessa O'Sullivan: Thank you.

End of Transcript